Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

Cambridgeshire Police And Crime Commissioner
2021/22

INDEX

1 INTRODUCTION 3
1.1 Background 3
1.2 Reporting requirements 4
1.3 Treasury Management Strategy for 2021/22 4
1.4 Training 5
2 THE CAPITAL PROGRAMME 2021/22 – 2024/25 6
2.1 Capital expenditure 7
2.2 The Commissioner's borrowing need (the Capital Financing Requirement) 7
2.3 Core funds and expected investment balances 7
2.4 Minimum revenue provision (MRP) policy statement 8
3 BORROWING 10
3.1 Current portfolio position 10
3.2 Treasury Indicators: limits to borrowing activity 11
3.3 Borrowing strategy 11
3.4 Policy on borrowing in advance of need 12
3.5 Debt rescheduling 12
4 ANNUAL INVESTMENT STRATEGY 13
4.1 Investment policy 13
4.2 Creditworthiness policy 14
4.3 Country and sector limits 16
4.4 Investment strategy 16
4.5 Investment risk benchmarking 17
4.6 End of year investment report 18
5 APPENDICES 19
5.1 APPENDIX: Prudential and Treasury Indicators 2021/22 – 2024/25 20
5.2 APPENDIX: Interest Rate Forecasts 2021 - 2024 23
5.3 APPENDIX: Economic Background 24
5.4 APPENDIX: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management 31
5.5 APPENDIX: Treasury Management scheme of delegation 33
5.6 APPENDIX: The Treasury Management role of the section 151 officer 34

1 INTRODUCTION

1.1 Background

The Police and Crime Commissioner ("the Commissioner") is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Commissioner's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Commissioner's capital plans. These capital plans provide a guide to the borrowing need of the Commissioner, essentially the longer term cash flow planning, to ensure that the Commissioner can meet the capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet the Commissioner's risk or cost objectives.

Separate to this, the capital strategy sets out the investment required in capital assets that the PCC anticipates making for the medium term. The Treasury Management strategy summarises the planned capital expenditure and sets out how the PCC will manage its borrowings and investments over the short and medium term. Alongside this, the asset management strategy will set out the framework for managing the property portfolio effectively in the short and medium term. It will guide future strategic property decisions to make sure the PCC manages its asset portfolio sustainably and efficiently so that it can adapt to remain fit for the future and support frontline delivery.

The contribution the treasury management function makes to the Commissioner is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

CIPFA defines treasury management as:

"The management of the local authority's [including the Commissioner] borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

This Commissioner has not engaged in any commercial investments and has no non-treasury investments.

To summarise, Treasury management is the management of the organisation's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks. The prime objective of the PCC's investment strategy is to maintain capital security whilst ensuring that there is the necessary liquidity to carry out its business. Within these constraints, the strategy aims to maximise returns.

1.2 Reporting requirements

1.2.1 Capital Strategy

The CIPFA 2017 Prudential and Treasury Management Codes require all local authorities, including the Commissioner, to prepare a capital strategy report, which will provide the following:

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

The aim of this capital strategy is to ensure that the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite are understood.

1.2.2 Treasury Management reporting

The Commissioner is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid-year treasury management report – This will update the Commissioner on the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.2.3 Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Commissioner. This role is undertaken by the Business Co-ordination Board.

1.3 Treasury Management Strategy for 2021/22

The strategy for 2021/22 covers two main areas:

Capital issues

- the capital plans and the prudential indicators;
- the Minimum Revenue Provision (MRP) policy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Commissioner;
- prospects for interest rates;

- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- the policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, Minsitry of Housing, Communities and Local Government (MHCLG) MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

Affordability and Financial Planning: The Capital Programme and the MTFS will include forecasts on capital expenditure, revenue consequences of capital programmes and the requirement to financially support capital investment, mainly through borrowing. This work will have identified the potential financial position for the Force in respect of the coming medium term, taking into account core known information and stated assumptions

Capital Sustainability: For the period of the MTFS (20/21 to 23/24) there is a move away from funding of the capital programme through use of capital reserves and grants into a position of funding through borrowing for specific projects. The replacement of the Parkside police station and custody provision in South Cambridgeshire is the largest capital project in recent years and will require a significant amount of capital investment.

Approval Process: Once the PCC has approved the capital programme, then capital expenditure can be committed against these approved schemes. Whether capital projects are funded from grant, capital allocations or borrowing, the revenue costs must be able to be met from existing revenue budgets. Following approval by the PCC capital expenditure is then monitored on a regular basis at the Force Executive Board and joint Business Coordination Board meetings.

Capital receipts: Capital receipts cannot be spent on revenue items but will reduce the requirement for borrowing. The PCC is currently reviewing the pool of surplus land and underutilised assets in its portfolio, and is appraising options to collaborate with Cambridgeshire Fire and Rescue Service (CFRS) in accommodating both police and fire together, which releases surplus land and building to realise a capital receipt.

Prudential Borrowing: The PCC can set their own borrowing levels based on capital need and the ability to pay for the borrowing. The levels will be set by using the indicators and factors set out in the Prudential Code. The borrowing costs are not supported by the Government so the PCC needs to ensure it can fund the repayment costs. Due to the ongoing debt charges (i.e. MRP and external interest charges) the Chief Finance Officer (CFO) will keep under review external borrowing and any potential alternative funding source for financing the capital programme.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that those with responsibility for treasury management, particularly those responsible for its scrutiny, receive adequate training in treasury management. The Commissioner and members of the substantive Joint Audit Committee will be provided with appropriate training. The training needs of treasury management officers are periodically reviewed.

2 THE CAPITAL PROGRAMME 2021/22 – 2024/25

The Commissioner's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans are reflected in the prudential indicators, which are designed to assist with this overview and confirmation of capital expenditure plans. These indicators are separated out in Appendix 5.1, with the following table providing a holistic overview.

Table 1

£000's		2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Opening Capital Financing Requirement (CFR)		**21,027**	**22,206**	**22,468**	**32,819**	**65,137**	**68,287**
Capital investment:							
Tangible assets additions		7,963	5,791	21,360	38,292	8,707	4,714
Intangible assets additions		1,155	-	-	-	-	-
TOTAL CAPITAL EXPENDITURE	(A)	**9,118**	**5,791**	**21,360**	**38,292**	**8,707**	**4,714**
Source of Finance:							
Capital receipts		(2,186)	(537)	(5,850)	(1,250)	-	(16,700)
Government Grants		(1,484)	(341)	(136)	(136)	(136)	(136)
Other sources		(523)	-	-	-	-	-
		(4,193)	**(878)**	**(5,986)**	**(1,386)**	**(136)**	**(16,836)**
Sums set aside from Revenue:							
Direct revenue contributions		(493)	(2,207)	(3,440)	(3,440)	(3,440)	(3,440)
		(493)	**(2,207)**	**(3,440)**	**(3,440)**	**(3,440)**	**(3,440)**
Reserves:							
Tfr from Capital Reserves		(696)	(1,722)	(602)	-	-	-
Tfr from Other Reserves		(1,843)	-	-	-	-	-
		(2,539)	**(1,722)**	**(602)**	**-**	**-**	**-**
TOTAL FINANCING	(B)	**(7,225)**	**(4,807)**	**(10,028)**	**(4,826)**	**(3,576)**	**(20,276)**
Net financing need	(A)+(B)	**1,893**	**984**	**11,332**	**33,466**	**5,131**	**(15,562)**
Minimum Revenue Provision (MRP)	(C)	**(714)**	**(722)**	**(981)**	**(1,148)**	**(1,981)**	**(2,478)**
Movement in CFR	(A)+(B)+(C)	**1,179**	**262**	**10,351**	**32,318**	**3,150**	**(18,040)**
Closing Capital Financing Requirement	(D)	**22,206**	**22,468**	**32,819**	**65,137**	**68,287**	**50,247**
Borrowing represented by:							
Loan Finance		17,839	17,302	37,100	59,113	58,198	36,886
Finance Lease		31	23	16	8	1	-
TOTAL BORROWING	(E)	**17,870**	**17,325**	**37,116**	**59,121**	**58,199**	**36,886**
Under/(Over) borrowing	(D)-(E)	**4,336**	**5,143**	**(4,297)**	**6,016**	**10,088**	**13,361**

Table 1 shows the movement in Capital Financing Requirement from the audited position in the 2019/20 accounts to the end of the Medium-Term Financial Strategy period. This takes account of the capital programme for the same period.

Total capital expenditure is shown, which for 2021/22 to 2024/25 amounts to £73.1m and includes a major project to replace the Parkside police station and custody provision in South Cambridgeshire.

Total financing includes the different sources of financing, direct revenue contributions and use of capital reserves.

The Minimum Revenue Provision is a charge to the revenue budget to reflect a repayment of the capital outlay (see 2.4 for more detail).

The Net Financing Need is the difference of capital expenditure to the total of financing available; this shows the requirement to borrow to support the current plans.

Table 1 also shows the currently under-borrowed position which is the difference of the Capital Financing Requirement and the current level of Loans and Finance Leases outstanding. The Commissioner needs to ensure that the gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2020/21 and the following two financial years. Therefore the over-borrowed position of £4.3m shown as expected in 2021/22 is acceptable in light of the CFR doubling from £32m to over £65m within 20222/23.

2.1 Capital expenditure

The Commissioner's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle are summarised within **Table 1**, and how the plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

2.2 The Commissioner's borrowing need (the Capital Financing Requirement)

The Capital Financing Requirement (CFR) is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Commissioner's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Commissioner's borrowing requirement, these types of scheme include a borrowing facility and so the Commissioner is not required to separately borrow for these schemes. The Commissioner currently has £23k (shown in **Table 1**, Finance Lease) of such schemes within the CFR.

2.3 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). **Table 2** shows estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Table 2 – Cash available to invest

YEAR END RESOURCES £000's		2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
General and Earmarked Reserve		16,310	15,792	15,065	15,122	14,584	14,584
Capital Receeipts Reserve		726	189	-	-	-	-
TOTAL RESERVES		**17,036**	**15,981**	**15,065**	**15,122**	**14,584**	**14,584**
Provisions		1,738	1,738	1,738	1,738	1,738	1,738
TOTAL CORE FUNDS AVAILABLE	(A)	**18,774**	**17,719**	**16,803**	**16,860**	**16,322**	**16,322**
Working Capital:							
Stock		1,100	1,100	1,100	1,100	1,100	1,100
Debtors		22,580	22,580	22,580	22,580	22,580	22,580
Creditors		(15,741)	(15,741)	(15,741)	(15,741)	(15,741)	(15,741)
		7,939	**7,939**	**7,939**	**7,939**	**7,939**	**7,939**
Under-borrowing		4,336	5,143	(4,297)	6,016	10,088	13,361
TOTAL EXISTING REQUIREMENT	(B)	**12,275**	**13,082**	**3,642**	**13,955**	**18,027**	**21,300**
Cash available to invest	(A)-(B)	**6,499**	**4,637**	**13,161**	**2,905**	**(1,705)**	**(4,978)**

Table 2 above shows the value of the remainder of core funds available to invest after consideration of cash backed reserves, provisions and the under-borrowed amount are offset against the working capital requirements of the organisation. The levels of provision and working capital are projected forward at the same level as for 2019/20 as no significant changes are envisaged.

With in-year borrowing for 2021/22 it is expected an increase cash balances will be seen for a short period prior, reducing as the capital expenditure takes place.

2.4 Minimum revenue provision (MRP) policy statement

The Commissioner is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

MHCLG regulations have been issued which require the Commissioner to approve **an MRP Statement** in advance of each year. A variety of options are provided to authorities, so long as there is a prudent provision. The Commissioner is recommended to approve the following MRP Statement:

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Existing practice** - MRP will follow the existing practice outlined in former MHCLG regulations. This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction). This option provides for a reduction in the borrowing need over approximately the asset's life.

Repayments included in annual PFI or finance leases are applied as MRP.

MRP Overpayments – a change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2020 the total VRP overpayments were zero.

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Commissioner. The Treasury Management function ensures that the Commissioner's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity and the Commissioners capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The overall Treasury Management portfolio as at 31 March 2020 and for the position as at 28 February 2021 are shown below for both borrowing and investments.

Table 3

TREASURY PORTFOLIO				
	31 March 2020		28 February 2021	
Treasury Investments	**£000**	**%**	**£000**	**%**
Banks (UK)	10,930	100%	11,480	49%
Banks (Rest of World)	0	0%	2,000	9%
Local Authorities	0	0%	0	0%
DMADF (H.M.Treasury)	0	0%	0	0%
Money Market Funds	0	0%	9,865	42%
Certificates of Deposit	0	0%	0	0%
Total Managed In-house	**10,930**	**100%**	**23,345**	**100%**
Bond Funds	0	0%	0	0%
Property Funds	0	0%	0	0%
Total Managed Externally	**0**	**0%**	**0**	**0%**
Total Treasury Investments	**10,930**	**100%**	**23,345**	**100%**
Treasury External Borrowing				
Local Authorities	0	0%	0	0%
PWLB	17,839	100%	17,535	100%
Total External Borrowing	**17,839**	**100%**	**17,535**	**100%**
Net Treasury Investments / (Borrowing)	**(6,909)**		**5,810**	

The Commissioner's forward projections for borrowing are summarised in **Table 1**, which shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Within the prudential indicators there are a number of key indicators to ensure that the Commissioner's activities are operated within well-defined limits. One of these is that the Commissioner needs to ensure that the gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2020/21 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Chief Finance Officer reports that the Commissioner complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

In order to calculate an operational boundary, an operational buffer of 10% is added to the value of the Capital Financing Requirement. In addition, where there is the potential for borrowing to be needed earlier than planned, the estimated loan requirement is also added.

The authorised limit for external debt. This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the Commissioner. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all authorities and councils' plans, or those of a specific authority or council, including the Commissioner, although this power has not yet been exercised.
2. The authorised limit has been determined to be 15% in excess of the operational boundary.
3. The below highlights the Authorised Limit the Commissioner has approved for 2021/22 and projects over the forecasting period the changes expected:

Table 4

LIMITS TO BORROWING ACTIVITY £000's	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Capital Financing Requirement (CFR)		22,468	32,819	65,137	68,287	50,247
Operational Margin (10% of CFR)		2,247	3,282	6,514	6,829	5,025
		24,715	**36,101**	**71,651**	**75,116**	**55,272**
Borrowing Capability Factor *		11,332	33,466	5,131	(15,562)	88
OPERATIONAL BOUNDARY	**20,003**	**36,047**	**69,567**	**76,782**	**59,554**	**55,360**
AUTHORISED LIMIT (15% above Operational Boundary)	**23,003**	**41,454**	**80,002**	**88,299**	**68,487**	**63,664**

** Net Financing Need (see Table 1) for following year brought forward - this allows for borrowing in readiness for expeced capital outlay*

3.3 Borrowing strategy

The Commissioner is currently maintaining an under-borrowed position (see **Table 1**). This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Commissioner's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 Treasury operations. The Chief Finance Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates* (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- *if it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast,* perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

3.4 Policy on borrowing in advance of need

The Commissioner will not borrow more than, or in advance of, its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Commissioner can ensure the security of such funds.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.5 Debt rescheduling

There are no plans for rescheduling our current borrowing in the debt portfolio. All rescheduling will be discussed with the Commissioner or Deputy Commissioner prior to any decision being taken.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

The Commissioner's investment policy has regard to the following:

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the CIPFA TM Code")
- CIPFA Treasury Management Guidance Notes 2018

The Commissioner's investment priorities will be security first, liquidity second, then return.

The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. The Commissioner has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
2. Other information: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Commissioner will engage with advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.
3. Other information sources used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
4. The Commissioner has defined the list of types of investment instruments that the treasury management team are authorised to use. There are two lists in appendix 5.4 under the categories of 'specified' and 'non-specified' investments.
    - Specified investments are those with a high level of credit quality and subject to a maturity limit of one year.
    - Non-specified investments are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e. an 18 month deposit would still be non-specified even if it has only 11 months left until maturity.
5. Non-specified investments limit. The Commissioner has determined that zero Non-specified investments will be undertaken. This will limit the maximum total exposure to non-specified investments to 0% of the total investment portfolio, (see paragraph 4.3).
6. Lending limits, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 4.2.
7. The Commissioner will set a limit for the amount of the investments which are invested for longer than 365 days, (see paragraph 4.4).

8. Investments will only be placed with counterparties from countries with a specified minimum sovereign rating, (see paragraph 4.3).
9. The Commissioner has engaged external consultants to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of the Commissioner in the context of the expected level of cash balances and need for liquidity throughout the year.
10. All investments will be denominated in sterling.
11. As a result of the change in accounting standards for 2019/20 under IFRS 9, the Commissioner will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund.

However, the Commissioner will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year - The above criteria are unchanged from last year.

4.2 Creditworthiness policy

The primary principle governing the Commissioner's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Commissioner will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Commissioner's prudential indicators covering the maximum principal sums invested.

The CFO will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to the Commissioner for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Commissioner may use, rather than defining what types of investment instruments are to be used.

Credit rating information is supplied by Link Asset Services, our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of the longer term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to a counterparty at the minimum of the Commissioner's criteria will be suspended from use, with all others being reviewed in light of market conditions.

The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:

- Banks 1 - good credit quality **–** the Commissioner will only use banks which:
  i. are UK banks; and/or
  ii. are non-UK and domiciled in a country which has a minimum sovereign Long Term rating of AA- and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):
  iii. Short Term – F1
  iv. Long Term – A-
- Banks 2 – Part nationalised UK bank – Royal Bank of Scotland. This bank can be included provided it continues to be part nationalised or it meets the ratings in Banks 1 above.
- Banks 3 – The Commissioner's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time invested.
- Money market funds (MMFs) CNAV – AAA
- Money market funds (MMFs) LVNAV – AAA
- Money market funds (MMFs) VNAV – AAA
- Ultra-Short Dated Bond Funds with a credit rating of at least 1.25 – AAA
- Ultra-Short Dated Bond Funds with a credit rating of at least 1.50 - AAA
- UK Government (including gilts, Treasury Bills and the DMADF)
- Local authorities, parish councils, Commissioners etc

A limit of 0% will be applied to the use of non-specified investments.

Use of additional information other than credit ratings. Additional requirements under the Code require the Commissioner to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating Watches/Outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and monetary limits applying to investments. The time and monetary limits for institutions on the Commissioner's counterparty list are as follows (these will cover both specified and non-specified investments):

	Fitch Rating	**Money and/or % Limit**	**Time Limit**
Banks 1 - higher quality	A- / F1	25% of available funds (max £10m)	364 days
Banks 2 – part nationalised	A- / F1	25% of available funds (max £10m)	364 days
Commissioner' bank (when not within Banks 1)		£10m	Overnight
DMADF	AAA	unlimited	6 months
Local authorities	N/A	£10m	364 days
	Fund rating	**Money and/or % Limit**	**Time Limit**
Money market funds CNAV	AAA	100% of available funds	Liquid
Money market funds LVNAV	AAA	100% of available funds	Liquid
Money market funds VNAV	AAA	100% of available funds	Liquid
Ultra-Short Dated Bonds Funds	AAA	100% of available funds	Liquid

The proposed criteria for specified and non-specified investments are shown in Appendix 5.4 for approval.

4.3 Country and sector limits

Due care will be taken to consider the country, group and sector exposure of the Commissioner's investments.

The Commissioner has determined that approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch or equivalent will be used. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

In addition:

- no more than 50% of available funds will be placed in a country outside of the UK (this applies to Banks 1 (see 4.2 above) only, not Money Market funds);
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

4.4 Investment strategy

In-house funds - Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment returns expectations - Bank Rate is unlikely to rise from 0.10% for a considerable period. It is very difficult to say when it may start rising so it may be best to assume that investment earnings from money market-related instruments will be sub 0.50% for the foreseeable future.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows (the long term forecast is for periods over 10 years in the future):

2020/21	0.10%
2021/22	0.10%
2022/23	0.10%
2023/24	0.10%
2024/25	0.25%
Later years	2.00%

- The overall balance of risks to economic growth in the UK is now probably more to the upside but is subject to major uncertainty due to the virus - both domestically and its potential effects worldwide.
- There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates anytime soon and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, or a return of investor confidence in equities, could impact gilt yields, (and so PWLB rates), in the UK.

Negative investment rates - While the Bank of England said in August / September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, and in February 2021 stated that financial institutions would not be ready to implement negative rates for six months, some deposit accounts were offering negative rates for shorter periods prior to this latest announcement. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the COVID crisis; this has caused some local authorities to have sudden large increases in cash balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

As for money market funds (MMFs), yields have fallen near to zero. Some managers have resorted to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a surfeit of money swilling around at the very short end of the market.

Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

Investment treasury indicator and limit - total principal funds invested for greater than 365 days. These limits are set with regard to the Commissioner's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Commissioner has approved the treasury indicator and limit for investments greater than 365 days as: -

Maximum principal sums invested > 364 days	2020/21	2021/22	2022/23
Principal sums invested > 364 & 365 days	£0	£0	£0

For its cash flow generated balances, the Commissioner will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 365 days) in order to benefit from the compounding of interest.

4.5 Investment risk benchmarking

These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

- Security - the Commissioner's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:
- 0.004% historic risk of default when compared to the whole portfolio.
- Liquidity - in respect of this area the Commissioner seeks to maintain:
- Bank overdraft - £100k
- Liquid short term deposits having the lower of at least £5m or 25% of funds available with a week's notice.
- Yield - local measures of yield benchmarks are:
- Investments - internal returns above the overnight LIBOR rate -0.25%

4.7 End of year investment report

At the end of the financial year, the Commissioner will report on the investment activity as part of the Annual Treasury Report.

5 APPENDICES

1. Prudential and treasury indicators
2. Interest rate forecasts
3. Economic background
4. Treasury management practice – credit and counterparty risk management
5. Treasury management scheme of delegation
6. The treasury management role of the section 151 officer

5.1 APPENDIX: Prudential and Treasury Indicators 2021/22 – 2024/25

5.1.1 Capital Expenditure

This provides a summary of the PCC's capital expenditure. It reflects matters previously agreed and those proposed for the forthcoming financial periods.

Capital Expenditure		2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Total Capital Expenditure	(A)	**9,118**	**5,791**	**21,360**	**38,292**	**8,707**	**4,714**
Financed by:							
Capital receipts		(2,186)	(537)	(5,850)	(1,250)	-	(16,700)
Revene contribution		(493)	(2,207)	(3,440)	(3,440)	(3,440)	(3,440)
Grants and other contributions		(4,546)	(2,063)	(738)	(136)	(136)	(136)
Finance lease and PFI liabilities		-	-	-	-	-	-
Total Financing	(B)	**(7,225)**	**(4,807)**	**(10,028)**	**(4,826)**	**(3,576)**	**(20,276)**
Net financing need for year	(A)-(B)	**1,893**	**984**	**11,332**	**33,466**	**5,131**	**(15,562)**

5.1.2 Capital Financing Requirement

This shows the difference between the PCC's capital expenditure and the revenue or capital resources set aside to finance that spend. The CFR will increase where capital expenditure takes place and will reduce as the PCC makes Minimum Revenue Provision ("MRP") or Voluntary Revenue Provision ("VRP") or otherwise sets aside revenue or capital resources to finance expenditure.

Capital Financing Requirement	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Opening CFR	21,027	22,206	22,468	32,819	65,137	68,287
Capital spend	9,118	5,791	21,360	38,292	8,707	4,714
Resources used	(7,225)	(4,807)	(10,028)	(4,826)	(3,576)	(20,276)
MRP & VRP	(714)	(722)	(981)	(1,148)	(1,981)	(2,478)
Closing CFR	**22,206**	**22,468**	**32,819**	**65,137**	**68,287**	**50,247**

5.1.3 Authorised Limit

This represents a control on the maximum level of external debt the PCC can incur. The PCC has to show this aggregate amount split into the element in respect of actual external borrowing and that which relates to 'other long-term liabilities' - the latter being credit arrangements, as defined in statute and which will include the principle element of any finance lease or Private Finance Initiative obligations payable.

Authorised Limit	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Borrowing	22,803	41,254	79,802	88,099	68,287	63,464
Other Long Term Liabilities	200	200	200	200	200	200
Total Authorised Limit	**23,003**	**41,454**	**80,002**	**88,299**	**68,487**	**63,664**

5.1.4 Operational Boundary

This is the limit beyond which external debt is not normally expected to exceed. Again, the PCC is required to disclose an aggregate limit and separately disclose the element that relates to actual external borrowing and that which relates to other long-term liabilities. Unlike the Authorised Limit, the Operational Boundary is not an absolute limit but it reflects the PCC's expectations of the level at which external debt would not ordinarily be expected to exceed.

Operational Boundary	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Borrowing	19,903	35,947	69,467	76,682	59,454	55,260
Other Long Term Liabilities	100	100	100	100	100	100
Total Operational Boundary	**20,003**	**36,047**	**69,567**	**76,782**	**59,554**	**55,360**

5.1.5 External Debt

The PCC has to disclose the closing balance for actual gross borrowing in respect of the financial period just ended, together with the level of other long-term liabilities and so the actual aggregate level of external debt at the Balance Sheet date. This clarifies the overall level of external debt, and allow comparison to the PCC's actual borrowing need as provided by the Gross debt and the CFR Indicator.

Actual External Debt as at 31st March	2020/21 Actual
Borrowing	17,302
Other Long Term Liabilities	23
Total External Debt	**17,325**

5.1.6 Gross Debt and the Capital Financing Requirement

The PCC should only borrow to support a capital purpose, and borrowing should not be undertaken for revenue or speculative purposes. If the level of gross borrowing is below the PCC's capital borrowing need – the CFR – it demonstrates compliance with the requirement of this Indicator.

Gross Debt and the CFR	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
CFR	22,206	22,468	32,819	65,137	68,287	50,247
Gross Borrowing	17,870	17,325	37,116	59,121	58,199	36,886
Under/(Over) Borrowing	**4,336**	**5,143**	**(4,297)**	**6,016**	**10,088**	**13,361**

5.1.7 Ratio of Financing Costs

This Indicator shows the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream – i.e. taxation and non-specific grant income. The higher the ratio, the higher the proportion of resources tied up just to service net capital costs, and which represent a potential affordability risk.

Ratio of Financing Costs		2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Interest cost on existing borrowing		627	604	579	553	526	526
Interest cost on new borrowing		-	-	-	611	1,287	1,278
Gains/losses on debt rescheduling		-	-	-	-	-	-
Interest and investment income		(175)	(114)	(114)	(114)	(114)	(114)
MRP & VRP		714	722	981	1,148	1,981	2,478
Total Financing Costs	(A)	**1,166**	**1,212**	**1,446**	**2,198**	**3,680**	**4,168**
Net Budget Requirement	(B)	**146,412**	**152,467**	**161,654**	**164,907**	**168,549**	**171,912**
Ratio of financing costs	(A)/(B)	**0.80%**	**0.79%**	**0.89%**	**1.33%**	**2.18%**	**2.42%**

5.1.8 Maturity Structure of Borrowing

The PCC is required to set gross limits on maturities for the periods shown and covers both fixed and variable rate borrowings. The reason being to try and control the PCC's exposure to large sums falling due for refinancing.

Maturity structure of borrowing:	Actual	Lower Limit	Upper Limit
Under 12 months	1%	0%	100%
12 months and within 24 months	2%	0%	100%
24 months and within 5 years	45%	0%	100%
5 years and within 10 years	9%	0%	100%
10 years and above	42%	0%	100%

5.1.9 Limit for Principal Sums Invested for Longer Than a Year

This Indicator is seeking to support control of liquidity risk. The limits should be set with regard to the PCC's liquidity needs and reduce the potential need to have to make early exit from an investment in order to recover funds.

	Actual	Limit
Upper limit on total principal sums invested longer than a year	£ -	£ -

5.2 APPENDIX: Interest Rate Forecasts 2021 - 2024

The PWLB rates below are based on the new margins over gilts announced on 26th November 2020. PWLB forecasts shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60
Bank Rate													
Link	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Capital Economics	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
5yr PWLB Rate													
Link	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
Capital Economics	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90	-	-	-	-	-
10yr PWLB Rate													
Link	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
Capital Economics	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	-	-	-	-	-
25yr PWLB Rate													
Link	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
Capital Economics	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	-	-	-	-	-
50yr PWLB Rate													
Link	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60
Capital Economics	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	-	-	-	-	-

5.3 APPENDIX: Economic Background

UK. The Bank of England's Monetary Policy Committee (MPC) kept **Bank Rate** and quantitative easing (QE) unchanged on 4th February. However, it revised its economic forecasts to take account of a third national lockdown which started on 5th January, which is obviously going to delay economic recovery and do further damage to the economy. Moreover, it had already decided in November to undertake a further tranche of quantitative easing (QE) of £150bn, to start in January when the previous programme of £300bn of QE, announced in March to June 2020, finished. As only about £16bn of the latest £150bn tranche had been used towards the end of January, it felt that there was already sufficient provision for QE - which would be made to last to the end of 2021. This implied that the current rate of purchases of £4.4bn per week would be slowed during the year.

Although its short-term forecasts were cut for 2021, the medium-term forecasts were more optimistic than in November, based on an assumption that the current lockdown will be gradually eased after Q1 as vaccines are gradually rolled out and life can then start to go back to some sort of normality. The Bank's main assumptions were:

- The economy would start to **recover strongly** from Q3 2021.
- **£125bn of savings** made by consumers during the pandemic will give a significant boost to the pace of economic recovery once lockdown restrictions are eased and consumers can resume high street shopping, going to pubs and restaurants and taking holidays.
- The economy would still recover to reach its **pre-pandemic level** by Q1 2022 despite a long lockdown in Q1 2021.
- **Spare capacity** in the economy would be eliminated in Q1 2022.
- The Bank also expects there to be **excess demand** in the economy by Q4 2022.
- **Unemployment** will peak at around 7.5% during late 2021 and then fall to about 4.2% by the end of 2022. This forecast implies that 0.5m foreign workers will have been lost from the UK workforce by their returning home.
- **CPI inflation** was forecast to rise quite sharply towards the 2% target in Q1 2021 due to some temporary factors, (e.g. the reduction in VAT for certain services comes to an end) and given developments in energy prices. CPI inflation was projected to be close to 2% in 2022 and 2023.

The Monetary Policy Report acknowledged that there were **downside risks** to their forecasts e.g. from virus mutations, will vaccines be fully effective, how soon can tweaked vaccines be devised and administered to deal with mutations? There are also issues around achieving herd immunity around the world from this virus so that a proliferation of mutations does not occur which prolong the time it takes for the global economy to fully recover.

The Report also mentioned a potential **upside risk** as an assumption had been made that consumers would only spend £6bn of their savings of £125bn once restrictions were eased. However, the risk is that that consumers could spend a lot more and more quickly.

The Bank of England also removed **negative interest rates** as a possibility for at least six months as financial institutions were not yet ready to implement them. As in six months' time the economy should be starting to grow strongly, this effectively means that negative rates occurring are only a slim possibility in the current downturn. However, financial institutions have been requested to prepare for them so that, at a future time, this could be used as a monetary policy tool if deemed appropriate. (Gilt yields and PWLB rates jumped upwards after the removal of negative rates as a key risk in the short-term.)

Prior to 4th February, the **MPC's forward guidance** outlined that the sequencing of a withdrawal of monetary policy support would be that Bank Rate would be increased first, and only once it had reached a certain level, 'around 1.5%', before a start would be made on winding down the stock of asset purchases made under QE. However, the MPC decided at the February meeting that this policy should be reviewed as to whether a start should be made first on **winding down QE** rather than raising Bank Rate.

The MPC reiterated its previous guidance that Bank Rate would not rise until inflation was sustainably above 2%. This means that it will tolerate inflation running above 2% from time to time to balance out periods during which inflation was below 2%. This is termed **average inflation targeting**.

There are two views in respect of Bank Rate beyond our three-year time horizon:

1. The MPC will be keen to raise Bank Rate as soon as possible in order for it to be a usable tool when the next economic downturn comes along. This is in line with thinking on Bank Rate over the last 20 years.
2. Conversely, that we need to adjust to the new post-pandemic era that we are now in. In this new era, the shift to average inflation targeting has set a high bar for raising Bank Rate i.e. only when inflation is demonstrably sustainably above 2%. In addition, many governments around the world have been saddled with high levels of debt. When central bank rates are low, and below the average GDP growth rate, the debt to GDP ratio will gradually fall each year without having to use fiscal tools such as raising taxes or austerity programmes, (which would depress economic growth and recovery). This could therefore result in governments revising the setting of mandates to their national central banks to allow a higher rate of inflation linked to other economic targets. This is the Capital Economics view – that Bank Rate will not rise for the next five years and will probably then struggle to get to 1% within 10 years.

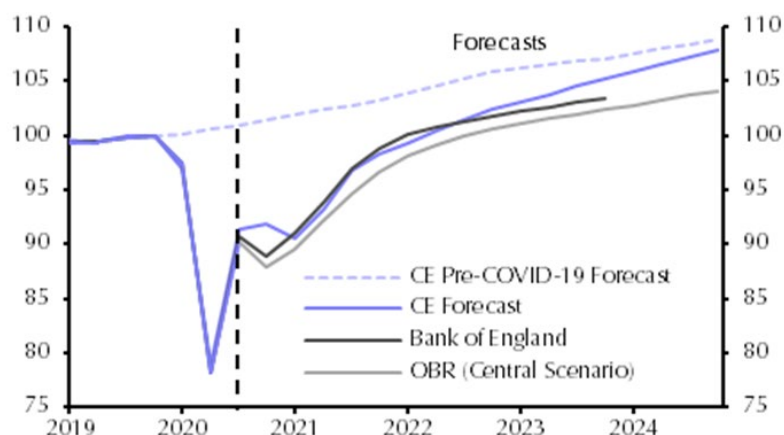
Public borrowing was forecast in November 2020 by the Office for Budget Responsibility (the OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of GDP. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so PWLB rates. However, the QE done by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with QE and debt issued in the US, the EU and Japan). This means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt. The OBR was also forecasting that the government will still be running a budget deficit of £102bn (3.9% of GDP) by 2025/26. However, initial impressions are that they have taken a pessimistic view of the impact that vaccines could make in the speed of economic recovery. It is now likely that total borrowing will probably reach around £420bn due to further Government support measures introduced as a result of further restrictions and the third national lockdown.

Overall, **the pace of recovery** was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp after quarter 1 saw growth at -3.0% followed by -18.8% in quarter 2 and then an upswing of +16.0% in quarter 3; this still left the economy 8.6% smaller than in Q4 2019. While the one month second national lockdown that started on 5th November caused a further contraction of 5.7% m/m in November, this was much better than had been feared and showed that the economy is adapting to new ways of working. This left the economy 'only' 8.6% below the pre-crisis level. However, a strong recovery from a further contraction during quarter 1 2021 is expected in the second half of 2021 and is likely to mean that the economy recovers to its pre-pandemic level during Q1 2022.

Vaccines – the game changer. The Pfizer announcement on 9th November of a successful vaccine has been followed by approval of the Oxford University/AstraZeneca and Moderna vaccines. The Government has set a target to vaccinate 14 million people in the most at risk sectors of the population by 15th February; it has made good, and accelerating progress in hitting that target. The aim is also to vaccinate all over 50s by May and all adults by September. This means that the national lockdown starting in early January, could be replaced by regional tiers of lighter restrictions, beginning possibly in Q2. At that point, there would be less reason to fear that hospitals could become overwhelmed any more. Effective vaccines have radically improved the economic outlook so that it may now be possible for GDP to recover to its pre-virus level as early as Q1 2022. These vaccines have enormously boosted confidence that life could largely return to normal during the second half of 2021. With the household saving rate having been exceptionally high since the first lockdown in March, there is plenty of pent-up demand and purchasing power stored up for when life returns to normal.

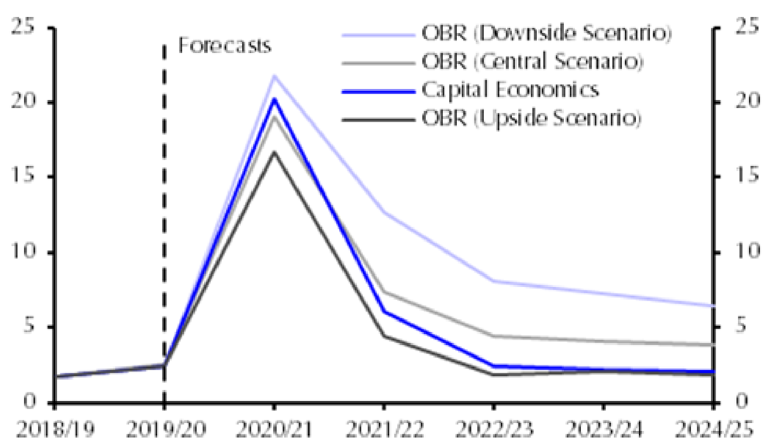
Provided that both monetary and fiscal policy are kept loose for a few years yet, then it is still possible that **in the second half of this decade**, the economy may be no smaller than it would have been if COVID-19 never happened. The major concern though, is that new mutations of the virus might defeat the current batch of vaccines. However, work is already advanced to produce what may well become annual revaccinations each autumn with updated vaccines. In addition, countries around the world have ramped up vaccine production facilities and vastly improved testing regimes; they are therefore now much better equipped to deal effectively with any new outbreaks of mutations of this virus.

Chart: Level of real GDP (Q4 2019 = 100)



This recovery of growth which eliminates the effects of the pandemic by about the middle of the decade, would have major repercussions for public finances as it would be consistent with the government deficit falling to around 2.5% of GDP without any tax increases. This would be in line with the OBR's most optimistic forecast in the graph below, rather than their current central scenario which predicts a 4% deficit due to assuming much slower growth. However, Capital Economics forecasts in the graphs above and below, assumed that politicians do not raise taxes or embark on major austerity measures and so, (perversely!), depress economic growth and recovery.

Chart: Public Sector Net Borrowing (as a % of GDP)



There will still be some **painful longer term adjustments** as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever, even if vaccines are fully successful in overcoming the current virus. There is also likely to be a **reversal of globalisation** as this crisis has exposed how vulnerable long-distance supply chains are. On the other hand, digital services are one area that has already seen huge growth.

Brexit. The final agreement of a trade deal on 24.12.20 has eliminated a significant downside risk for the UK economy. The initial agreement only covers trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be

formalised on a permanent basis. However, it is evident from problems with trade flows at ports in January and February, that work needs to be done to smooth out the issues and problems that have been created by complex customs paperwork, in order to deal with bottle necks currently being caused.

Fiscal policy. In December, the Chancellor made a series of announcements to provide further support to the economy: -

- An extension of the COVID-19 loan schemes from the end of January 2021 to the end of March.
- The furlough scheme was lengthened from the end of March to the end of April.
- The Budget on 3.3.21 will lay out the "next phase of the plan to tackle the virus and protect jobs". This does not sound like tax rises are imminent, (which could hold back the speed of economic recovery).

The **Financial Policy Committee** (FPC) report on 6.8.20 revised down the expected credit losses for the banking sector to "somewhat less than £80bn". It stated that in its assessment, "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

US. Following elections for two senate seats in January, the Democrats now have a majority in the House of Representatives and a very slim majority in the Senate based on the vice president's casting vote. As the Democrats will be dependent on gaining the support of moderate Democrat senators, there will be a limit on just how radical they can be with their legislative and financial programmes. The $900bn fiscal stimulus passed in December will help the economy gain more traction in early 2021. There is a question mark, however, over whether they will be able to get a much bigger $1.9bn fiscal stimulus through both houses, though a smaller package would stand much more chance of being approved. The rapid roll out of vaccines is well on course to vaccinate nearly the entire population by the end of the summer; this will help to underpin a strong economic recovery in 2021 after the economy wilted during Q4 2020 as more restrictions were imposed to contain the pandemic.

After Chair Jerome Powell unveiled the **Fed's adoption of a flexible average inflation target** in his Jackson Hole speech in late August 2020, the mid-September meeting of the Fed agreed by a majority to a toned down version of the new inflation target in his speech - that "it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time." This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary "trap" like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade, (and in 2020), so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting. The FOMC's updated economic and rate projections in mid-September showed that under this new regime of average inflation targeting, that officials expected to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. Where the Fed has led in changing its monetary policy to one based on average inflation targeting in response to the damage that this pandemic has done to the economy, there was much expectation that other major central banks would also follow suit.

Subsequent meetings of the Fed have projected that inflation will not get back sustainably to above 2% for some years and so the vast majority of Fed officials expect the Fed funds rate to still be at near-zero until 2024 or later. The key message is that policy will remain unusually accommodative – with near-zero rates and asset purchases continuing for several more years. This is likely to result in keeping Treasury yields lower than might otherwise be expected, although treasury yields have increased somewhat due to financial markets adjusting to expectations of higher rates of inflation.

EU. The economy was recovering well from the first lockdowns towards the end of Q2 and during Q3 after a sharp drop in GDP. However, a second wave of the virus has caused a renewed fall back in growth during Q4. The slow role out of vaccines during Q1 2021 will delay economic recovery. In Q2 of 2020, GDP was 15% below its pre-

pandemic level. But in Q3 the economy grew by 12.5% q/q leaving GDP down by "only" 4.4%. That was much better than had been expected earlier in the year. However, growth contracted by another 0.7% in Q4 and is likely to at least stagnate during Q1 of 2021, as a second wave of the virus has seriously affected many countries. The €750bn fiscal support package eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support, and quickly enough, to make an appreciable difference in the countries most affected by the first wave.

With **inflation** expected to be unlikely to get much above 1% over the next two years, **the ECB** has been struggling to get inflation up to its 2% target. It is currently unlikely that it will cut its central rate even further into negative territory from -0.5%, although the ECB has stated that it retains this as a possible tool to use. The ECB's December meeting added a further €500bn to the PEPP scheme, (purchase of government and other bonds), and extended the duration of the programme to March 2022 and re-investing maturities for an additional year until December 2023. Three additional tranches of TLTRO, (cheap loans to banks), were approved, indicating that support will last beyond the impact of the pandemic, implying indirect yield curve control for government bonds for some time ahead. The Bank's forecast for a return to pre-virus activity levels was pushed back to the end of 2021, but stronger growth is projected in 2022. The total PEPP scheme of €1,850bn of QE which started in March 2020 is providing protection to the sovereign bond yields of weaker countries like Italy. There is therefore unlikely to be a euro crisis while the ECB is able to maintain this level of support. However, as in the UK and the US, the advent of highly effective vaccines will be a game changer once the EU can get a comprehensive vaccination scheme up and running, although growth will struggle before later in quarter 2 of 2021.

China. After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in the rest of 2020; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth. At the same time, China's economy has benefited from the shift towards online spending by consumers in developed markets. These factors help to explain its comparative outperformance compared to western economies. However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns in the longer term. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

Japan. A third round of fiscal stimulus in early December took total fresh fiscal spending this year in response to the virus close to 12% of pre-virus GDP. That's huge by past standards, and one of the largest national fiscal responses. The budget deficit is now likely to reach 16% of GDP this year. Coupled with Japan's relative success in containing the virus without draconian measures so far, and the likelihood of effective vaccines being available in the coming months, the government's latest fiscal effort should help ensure a strong recovery and to get back to pre-virus levels by Q3 2021 – around the same time as the US and much sooner than the Eurozone. However, on the negative side, it has also been struggling - despite huge monetary and fiscal stimulus - to get out of a deflation trap for many years and to achieve consistent, significant GDP growth. Moreover, it has not consistently managed to raise inflation up to its target level of 2% and it is making little progress on fundamental reform of the economy.

World growth. World growth has been in recession in 2020 and this is likely to continue into the first half of 2021 before recovery in the second half. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

Until recent years, world growth has been boosted by increasing **globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected

sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a **reversal of world globalisation and a decoupling of western countries** from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation.

Economic Summary

Central banks are, therefore, likely to support growth by maintaining loose monetary policy through keeping rates very low for longer. Governments could also help a quicker recovery by providing more fiscal support for their economies at a time when total debt is affordable due to the very low rates of interest. They will also need to avoid significant increases in taxation or austerity measures that depress demand and the pace of recovery in their economies.

If there is a huge surge in investor confidence as a result of successful vaccines which leads to a major switch out of government bonds into equities, which, in turn, causes government debt yields to rise, then there will be pressure on central banks to actively manage debt yields by further QE purchases of government debt; this would help to suppress the rise in debt yields and so keep the total interest bill on greatly expanded government debt portfolios within manageable parameters. It is also the main alternative to a programme of austerity.

INTEREST RATE FORECASTS

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is now probably more to the upside but is subject to major uncertainty due to the virus - both domestically and its potential effects worldwide.
- There is relatively little domestic risk of increases or decreases in Bank Rate in the near-term, nor significant changes in shorter-term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates anytime soon but increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, could impact gilt yields, (and so PWLB rates).

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Mutations of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, resulting in further national lockdowns or severe regional restrictions.
- UK government takes too much action too quickly to raise taxation or introduce austerity measures that depress demand and the pace of recovery of the economy.
- UK - Bank of England takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- UK / EU trade arrangements – if there was a major impact on trade flows due to complications with customs paperwork or lack of co-operation in sorting out significant issues. A resurgence of the Eurozone sovereign debt crisis. The ECB has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for “weaker” countries. In addition, the EU agreed a €750bn fiscal support package. These actions will help shield weaker economic regions for the next two or three years. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between northern EU countries favouring low debt to GDP and annual balanced budgets and southern countries who want to see jointly issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.
- Weak capitalisation of some European banks, which could be undermined further depending on extent of credit losses resultant of the pandemic.

- German minority government & general election in 2021. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Angela Merkel has stepped down from being the CDU party leader but she will remain as Chancellor until the general election in 2021. This then leaves a major question mark over who will be the major guiding hand and driver of EU unity when she steps down.
- Other minority EU governments. Italy, Spain, Austria, Sweden, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- Austria, the Czech Republic, Poland and Hungary now form a strongly anti-immigration bloc within the EU, and they had threatened to derail the 7 year EU budget until a compromise was thrashed out in late 2020. There has also been a rise in anti-immigration sentiment in Germany and France.
- Geopolitical risks, for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- UK - a significant rise in inflationary pressures e.g. caused by a stronger than currently expected recovery in the UK economy after effective vaccines are administered quickly to the UK population, leading to a rapid resumption of normal life and return to full economic activity across all sectors of the economy.
- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a rapid series of increases in Bank Rate to stifle inflation.

5.4 APPENDIX: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

The MHCLG issued Investment Guidance in 2018, and this forms the structure of the Commissioner's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for councils and authorities to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires the Commissioner to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. The former Police Authority adopted the Code in February 2006 and the Commissioner will apply its principles to all investment activity. In accordance with the Code, the Director of Finance has produced the treasury management practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

Annual investment strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Commissioner will use. These are high security (i.e. high credit rating, although this is defined by the Commissioner, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Commissioner is:

Strategy guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Commissioner has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK treasury bills or a gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, housing association, parish council or community council.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's and / or Fitch rating agencies.
5. A body that is considered of a high credit quality (such as a bank or building society). For category 5 this covers bodies with a minimum Short Term rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's and / or Fitch rating agencies.

Within these bodies, and in accordance with the Code, the Commissioner has set additional criteria to set the time and amount of monies which will be invested in these bodies. These criteria are set out below:

	Fitch Rating	Money and/or % Limit	Time Limit
Banks 1 - higher quality	A- / F1	25% of available funds (max £10m)	364 days
Banks 2 – part nationalised	A- / F1	25% of available funds (max £10m)	364 days
Commissioner' bank (when not within Banks 1)		£10m	Overnight
DMADF	AAA	unlimited	6 months
Local authorities	N/A	£10m	364 days
	Fund rating	**Money and/or % Limit**	**Time Limit**
Money market funds CNAV	AAA	100% of available funds	Liquid
Money market funds LVNAV	AAA	100% of available funds	Liquid
Money market funds VNAV	AAA	100% of available funds	Liquid
Ultra-Short Dated Bonds Funds	AAA	100% of available funds	Liquid

Non-specified investments – not used

The monitoring of investment counterparties - The credit rating of counterparties will be monitored regularly. The Commissioner receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Chief Constable's CFO, and if required new counterparties which meet the criteria will be added to the list.

5.5 APPENDIX: Treasury Management scheme of delegation

(i) Commissioner / Business Co-Ordination Board (BCB)

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

(ii) Commissioner / BCB

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Resources Group / Commissioner

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

5.6 APPENDIX: The Treasury Management role of the section 151 officer

The S151 officer (CFO to PCC)

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.